



Agenda Date: 8/16/06

Agenda Item: 8B

## STATE OF NEW JERSEY

### Board of Public Utilities

Two Gateway Center

Newark, NJ 07102

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### DIVISION OF AUDITS

I/M/O THE FOCUSED AUDIT OF THE	)	
AFFILIATED TRANSACTIONS BETWEEN	)	ORDER
SOUTH JERSEY GAS COMPANY AND	)	
SOUTH JERSEY INDUSTRIES AND ITS	)	
AFFILIATES PURSUANT TO <u>N.J.S.A. 48:3-49,</u>	)	
<u>48:3-55, 48:3-56, 48:3-58 &amp; N.J.A.C. 14:4-5 et seq.</u>	)	
AND MANAGEMENT AUDIT OF SOUTH JERSEY	)	DOCKET NO. AX04040277
GAS COMPANY PURSUANT TO <u>N.J.S.A. 48:2-16.4</u>	)	
& <u>N.J.A.C. 14:3-12.1- CONSULTANTS REPORT</u>	)	

(SERVICE LIST ATTACHED)

BY THE BOARD<sup>1</sup>:

At its Agenda Meeting of July 7, 2004, the New Jersey Board of Public Utilities ("Board") authorized the initiation of a Gas Supply Focused Audit, a Management Audit, and a Competitive Services Audit (collectively "Audit" or "Focused Audit") of South Jersey Gas Company ("SJG" or "Company") and South Jersey Industries ("SJI") and its affiliates. The Gas Supply Focused Audit was initiated because of concerns expressed by the Energy Division on the allocation of interstate capacity, as well as stated concerns in the most recent Competitive Service Audit report in Docket No. GA02020101, dated March 14, 2003<sup>2</sup>.

Pursuant to the Board agenda meeting of September 22, 2004, the Liberty Consulting Group ("Liberty" or "Consultant") was selected by the Board to conduct the Audit of South Jersey Gas Company. The Focused Audit was completed in accordance with the contract between the Board and Liberty. Liberty's Final Audit Report, which was segmented into four volumes, contained a total of 136 recommendations. On April 15, 2005, Liberty submitted confidential and redacted versions of their final Focused Audit Reports for Volumes 1: Gas Supply and Volume 2: Cost Allocations and Affiliate Relationships. Subsequently on April 22, 2005 Liberty submitted confidential and redacted versions of their Final Focused Audit Reports for Volumes 3: EDECA Affiliate Standards and Volume 4: Management and Operations. This order

<sup>1</sup> Commissioner Christine V. Bator recused herself on this matter pending the resolution of questions related to a potential conflict of interest.

<sup>2</sup> I/M/O the Consultant's Reports Regarding the Audits of the Competitive Services Offerings of South Jersey Gas Company, BPU Docket No. GA02020101.

addresses Liberty's recommendations, along with the Ratepayer Advocate's ("Ratepayer Advocate" or "RPA") commentary and SJG's reply commentary as to said recommendations.

### Background

SJG had two full comprehensive Management Audits performed on its internal workings and operations during 1984-1985 (Docket No. 849-1045) and during 1990-1992 (Docket No. GA90030244). Also, during 1994-1995 SJG had a Focused Audit performed on its existing gas supply needs and its gas supply strategies and capability for the future (Docket No. GA94110526).

The current assignment was developed in two phases. The first phase was undertaken on a fast track and concentrated on SJG's procurement strategies; and in particular the impact of transactions by and with affiliates of SJI, on a retail and wholesale basis. The second phase focused on all other aspects of the utility, including the organizational structure of SJG, its financial controls, financial integrity, and corporate accountability. The second phase also incorporated all the requirements that are part of the Electric Discount Energy Competition Act ("EDECA").

On August 2, 2005, SJG responded to the Focused Audit reports in two separate letters. Of the 136 recommendations in Liberty's reports, SJG agreed to unconditionally take action to implement 118 of them. Regarding the remaining recommendations, SJG completely disagreed with three (3) recommendations and accepted fifteen (15) recommendations in concept, but requested further clarification and/or exception.

At the February 1, 2006 agenda meeting, Board Staff from both the Audits Division and the Energy Division (collectively "Staff") recommended that the Board accept all four volumes of Liberty's Focused Audit Report for filing purposes only; authorize the release the redacted volumes of the report to the public for comment due by February 24, 2006; release of the confidential volumes of the report to appropriate parties, with the proper confidentiality agreement; and authorize the release of the 20% hold-back owed to Liberty, in accordance with the Consultant's contract. These actions were adopted by the Board. The Division of the Ratepayer Advocate ("Ratepayer Advocate", "RPA")<sup>3</sup> hired a consultant to review the entire report (approximately 600 pages) and on February 17, 2006 requested an additional sixty days, until April 25, 2006, to file additional comments on this report. This extension was granted at the Board's April 12, 2006 Board Agenda Meeting.

### Ratepayer Advocate Comments

By letter dated April 25, 2006, the RPA submitted its comments concerning this matter to the Board. The Ratepayer Advocate supported the implementation of all of Liberty's recommendations with certain modifications. In its comments, the RPA expressed concern in four general areas. Specifically, the Division of Ratepayer Advocate argued that:

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<sup>3</sup> Pursuant to the Public Advocate Restoration Act of 2005 ("Act") the Department of the Public Advocate was restored as a principal department in the Executive Branch of State government. As a result of the Act, the Division of the Ratepayer Advocate became known as the Division of Rate Counsel under the Department of the Public Advocate.

- 1) The audit process should allow for more timely and meaningful input from the RPA and other interested parties;
- 2) The implementation process should include the Ratepayer Advocate to ensure the Company's timely compliance with the audit recommendations. The RPA asserts that it should be a part of any negotiations between the Company and Staff with regard to the content of the Company's Compliance Plan and the Company's progress toward implementing the plan;
- 3) Seven (7) of the 18 recommendations that SJG either disagreed with or agreed with in concept but sought clarification and/or exception of, warranted comment by the RPA or should be modified; and
- 4) There are an additional five issues raised in Liberty's Final Audit Report that Ratepayer Advocate feels were not properly or fully resolved by either Liberty or SJG.

#### SJG Reply Comments

In a letter to the Board dated May 17, 2006, SJG responded to Rate Counsel's comments. SJG stated that the Company stands by its original comments addressing Liberty's Final Audit recommendations, submitted in its two letters dated August 2, 2005. SJG did, however, address three (3) specific comments made in Rate Counsel's April 25, 2006 letter filing to the Board. Specifically, the Company argued:

- 1) The Company believes the issue of certain equipment leased, and later sold, to an affiliate was completely resolved in the terms of another settlement.
- 2) The Company believes that the imposition of sanctions, as recommended by the Ratepayer Advocate would be unduly punitive, and without cause.
- 3) The Company believes that the RPA has misperceived the functions of members of the Board of Directors, and believes that the RPA's assertion that separate directors for SJG and SJG are needed should be rejected.

On May 25, 2006, the Ratepayer Advocate filed reply comments to the SJG letter of May 17, 2006, disagreeing with several positions taken by SJG.

#### Issues

Liberty Recommendation GS-20- *Establish a mechanism for making marketer assets available to continue serving customers upon market exit or bankruptcy.* The Company has taken the position that this recommendation should have been directed to the Board as a generic policy matter affecting all gas utilities and third-party suppliers, rather than solely to SJG. The Ratepayer Advocate agrees with Liberty's recommendation, and disagrees with the Company's suggestion that it be considered only as part of a generic proceeding. The RPA asserts that the practice of maintaining significant levels of capacity to provide for customer turn-backs, is unique to SJG among New Jersey's four natural gas utilities and it is therefore appropriate to address this issue for SJG only.

Liberty Recommendation GS-22. *Develop procedures and ground rules for negotiating flex-rate contracts.* The Company, in its August 2, 2005 letter, agreed with the concept of the recommendation, but believes that written procedures and guidelines will serve little or no

benefit to the negotiations of flex-rate contracts. SJG asserts that beyond what already exists in its tariff, each flex-rate contract has its own set of circumstances, not lending itself to a common set of procedures or guidelines. The RPA states that while it would be nearly impossible to foresee all of the various types of hardships that customers requesting flexible rates might claim, it is nevertheless possible and appropriate for SJG to document the general guidelines that it, the RPA, and the Board will use when evaluating requests for flexible rates.

Liberty Recommendation CA-4. *Distribute the tax benefits that SJI realizes from the ESOP and 401(k) plan in a manner that reflects which entities caused the benefit and by how much, and revise SJG's books for 2004 accordingly.* SJG agreed with Liberty's conclusion that SJI erred in not sharing tax benefits with its subsidiaries, and further agreed to implement the recommendation on a going-forward basis. The Company, however, believes that a requirement to revise the Company's financial statements for 2004 has far reaching financial implications which are not justified simply to fix this item. The Ratepayer Advocate argued that restatement of SJG's 2004 financial statements would not result in any immediate impacts on rates and thus may not be necessary at this time. However, the RPA believes that in the event the Board does not require the recommended adjustment, SJG should retain the information and data that would allow the company to restate the Company's financial statements for 2004 should it be found desirable or necessary to do so within a reasonable period of time.

Liberty Recommendation ED-1 *Treat South Jersey Energy ("SJE") energy services, HVAC installations by South Jersey Energy Services Plus (SJESP") energy product development and plant management and operation by Marina Energy, LLC ("Marina"), meter reading services by Millennium and air monitoring services by AirLogics as SJI holding company Related Competitive Business Segments ("RCBS") for purposes of applying the standards; and*

Liberty Recommendation ED-2 *Cease the practice of deeming retail activities permissible because the BPU has not specifically declared them to be "competitive," and make the change clear to employees through an immediate, supplemental communications program.*

The above two recommendations, with which SJG was initially in disagreement, relate to the definition of an RCBS. The definition of an RCBS has been an ongoing source of contention between SJG and Board Staff. SJG's concern is that Liberty has considered one of SJG's affiliates, Marina as an RCBS. SJG states that Marina does not provide any retail related services, and although three officers hold positions in SJI, SJG and Marina, the Company feels that from a cost effective and risk management perspective, it can balance the risk framework of Marina within the entire risk profile of SJI. The RPA asserts that the current interlocking directorates involve serious conflict and potential conflicts of interest to the detriment of SJG's ratepayers. The RPA points to one such conflict which is apparent from Liberty's descriptions of Marina's business activities. According to the Final Report, Marina is engaged in "developing, owning, and operating projects that supply thermal and electrical energy to large commercial and industrial end-users." Final Report, Volume 3, Page 5. These operations include "significant gas supply operations" for a large thermal energy complex in Atlantic City. Id., Volume 1, Page 133, 128. Marina is currently purchasing gas supply for this facility from SJE which, as discussed above, has been the beneficiary of significant ratepayer-provided subsidies. Thus, according to the RPA, Marina and SJG's ratepayers have conflicting interests in the terms Marina's gas supply arrangements. The RPA asserts that separate directors for SJI and SJG are needed to assure that such gas supply arrangements are on terms that are fair to SJG's ratepayers.

Subsequent to their original recommendation, Liberty Consulting has agreed that smaller companies such as Marina could be exempt from separate senior executives, specifically the CEO, CFO, and General Counsel. Liberty concluded that a smaller company, on an affirmative



period of time early in the development of such new enterprises. SJG subsequently indicated to Audit Staff that they are requesting this exemption for an unspecified period of time until Marina begins to become a more mature business. The RPA does not believe that an exemption should be granted, because of the significant amount of gas supply that Marina uses.

Liberty Recommendation MO-2. *Eliminate the requirement that the Nominating and Governance Committee take counsel from inside directors in recommending committee chairs to the full board.* The Company agreed with the intent of the recommendation. However, SJG argues that the Chairman and CEO of the Company need to be part of the process of selection of Committee chairs and the process must be a collaborative one. The RPA states that Liberty's recommendation does not preclude the Nominating and Governance Committee from seeking counsel in this regard from either the Chairman or CEO, and recommends that the Nominating and Governance Committee be independent from influence by the Chairman or the CEO should it so choose.

Liberty Recommendation MO-7 *Adopt a lower threshold for the level of business dealings that may be permitted enterprises that board members are associated with, on the one hand, and SJI entities, on the other hand.* This was the third recommendation with which SJG disagreed. The Company asserts that the independence standards set by the New York Stock Exchange ("NYSE") are the appropriate measures for establishing thresholds regarding transactions between directors and the Company. The Ratepayer Advocate supports Liberty's recommendation. The RPA believes the NYSE rules are not strict enough to protect SJG's and its ratepayers' interests. In support of its argument, the RPA cites Liberty's finding of several instances where "independent" directors either had or were trying to secure significant business arrangements with SJI and affiliates. The Ratepayer Advocate recommends that the Board require SJI/SJG to establish appropriate thresholds regarding transactions between directors and the Company. Liberty has forwarded a letter to Staff and the Company withdrawing this recommendation. Liberty Consulting stated that based upon its further review of the Company's corporate governance policies and the fact that the Company has met the NYSE requirements, this recommendation is no longer valid. The corporate governance regulations are in a state of flux due to the repeal of the federal Public Utility Holding Company Act ("PUHCA"), ongoing modifications of the Sarbanes-Oxley Act, the most recent rules of the NYSE, together with pending PUHCA regulations at the state level.

Liberty Recommendation GS-12. *Require SJG to demonstrate the cost-effectiveness of the Transco Lateral expansion through the BGSS process.* SJG accepted this recommendation by Liberty. The RPA supported the recommendation, but noted that although the recently approved Global Settlement involving SJG addressed the Transco Lateral expansion project, that settlement did not fully resolve Liberty's recommendation GS-12. The RPA asks that the Board in its Order adopting Liberty's Final Audit Report make it clear that SJG is required to perform the recommended comprehensive analyses of capacity alternatives.

*Volume 3, Section III B. Conclusion 3A- The composition and application of the three-factor allocator are reasonable, and the method used for making the calculations needs only minor corrections.* The RPA agrees that it is appropriate for SJI to use an equally weighted three-part factor to allocate certain indirect costs among affiliates where there is no actual cost-causative basis for allocating such costs to the affiliates. However, the RPA asserts that "margins" should not be allowed as one of the three factors used in the Company's blended ratio to allocate indirect costs to its affiliates and subsidiaries. The RPA advises that a more proper formula is the "Modified Massachusetts Formula" which uses assets, payroll (labor) and gross revenue as the three factors. The RPA recommends that SJI and SJG modify its three-part allocation factor to exclude margin as one of the three measures, and to include a factor representing revenue in its place.

to exclude margin as one of the three measures, and to include a factor representing revenue in its place.

*Volume 3, Section V.M. Conclusion 4A- SJG provided material customer enrollment, marketing and business development assistance to SJE and SJESP in violation of the requirements of Section 14:4-5.3(m).* The RPA believes that this action should be subject to a financial penalty under N.J.A.C 14:4-5.8 (a). Liberty found that SJE was "unusually successful in gaining market share in SJG's territory," and thus was a primary beneficiary of the subsidy created by the Company's practice of providing for customer turn-backs as part of its capacity planning process. The RPA believes that this may have occurred in part due to SJG's improper use of utility resources to promote SJE's marketing activities. The RPA believes that it would be appropriate to compensate SJG's Basic Gas Supply Service ("BGSS") customers for some of the contribution to the costs of capacity that were lost to the BGSS Clause as a result of customer migration to SJE.

*Volume 3, Section VII.U. Conclusion 4d- SJG leased equipment to AirLogics and later sold the equipment to this affiliate without a prior examination of either the book or market price; and Conclusion 4e- SJG leased equipment to AirLogics and later sold the equipment to this affiliate at less than market price.* Liberty's recommendations ED-31 through ED-35 include a number of measures to assure that future inter-affiliate transfers of goods and services are charged at the proper costs under the Board's Affiliate Relations Standards. In its comments, the RPA notes that the costs of the air monitoring equipment referred to in this conclusion was funded by SJG's ratepayers on a "pass-through" basis through the Company's Remediation Adjustment Clause ("RAC"). The RPA asserts that the company should be required to determine the proper costs for the sale and lease transactions involving the air monitoring equipment, and to demonstrate that these amounts have been reflected in the Company's RAC accounts for the benefit of ratepayers. In its May 17, 2006 reply comments, the Company notes that this matter has already been completely resolved via a Stipulation entered into by the Company, Energy Staff, and the RPA, which was accepted by Board Order dated August 19, 2003 in Docket Nos. GR99070508, GR00090704, and GR01080472. The Company asserts that it complied with the terms of the settlement and Order by making a payment of three hundred thousand dollars (\$300,000) to the RAC, which ultimately benefited SJG's ratepayers. The Stipulation further stated, "This one-time credit shall constitute full and complete release and acquittance for any claims that have been made or may be made that South Jersey's customers are entitled to any form of credit or compensation because of the AirLogics operations." SJG believes the Company was compliant with the terms of the settlement and believes that no further action is warranted regarding this issue. In the RPA's reply comments submitted on May 25, 2006, they argue that the RPA has recommended that the Board implement remedies for SJG's *decision* to enter into a below-market lease, and later a below-market sale, of *utility assets*. The RPA asserts that the issues raised in the Liberty audit relate to transactions that were not addressed in the Global Settlement. SJG argues that the Global Stipulation resolves claims that ratepayers are entitled to compensation "because of the AirLogics operation." According to the RPA, the issues raised in the Liberty audit do not concern the operations of AirLogics, an unregulated affiliate of SJG. Those issues concern the actions of the regulated utility, SJG, and its assets.

*Liberty Recommendation MO-29. Require all employees, except for senior officers to routinely complete time sheets.* The RPA asserts that like all other workers, SJI and SJG's senior officials spend identifiable amounts of time working on assignments related to a single affiliate or group affiliates. Furthermore, charges for that time should be directly assigned to the appropriate affiliates, but appropriate charging of affiliates cannot be done if accurate time records are not being kept by senior officers. The RPA recommends that the Board modify recommendation MO-29, eliminating the exception for senior officers to complete time sheets.

In addition, the RPA requests that the Board also require that SJJ/SJG discontinue its current practice of *Exception Time Reporting*. According to the RPA, under the current practice, payroll assumes that all of an individual's time is associated with one project or one affiliate, unless notified by an exception. The RPA believes that this type of practice can lead to mis-assignment of cost responsibility. The RPA also notes that all other New Jersey jurisdictional utilities and their holding companies require positive time reporting.

## DISCUSSION AND FINDING

With respect to Liberty recommendation GS-20, the Board is persuaded by the RPA's argument that while a generic issue, the significant levels of capacity maintained to provide for customer turn-backs is unique to SJG. Therefore, the Board **HEREBY ACCEPTS** Liberty's position that this recommendation should be implemented as written and that this item should not be expanded to include other gas providers.

Liberty's recommendation GS-22 has merit and is reasonable. While the Company did not oppose the concept, the Company argued that written procedures and guidelines would serve little or no benefit to the negotiations of flex-rate contracts, the Board believes that it could provide a basis for negotiation discussions. Although the Board recognizes that each situation is unique, there are basic considerations and fact finding information that guides the utility in assessing any flex-rate contract negotiations. It would be the Company's responsibility to develop its own internal system and procedures but all flex-rate contracts would be reviewed by the Board as part of a separate proceeding filed by the Company. In these proceedings, the Board has the right to review such internal controls for sufficiency as part of its regulatory oversight. Thus, the Board **HEREBY ACCEPTS** Liberty's recommendation GS-22 concerning procedures and ground rules for negotiating flex-rate contracts.

With respect to Liberty recommendation CA-4, regarding the distribution of the tax benefits that SJJ realizes from the ESOP and 401(k) plan, the Board **AGREES** with Liberty and that the distribution should be done in a manner that reflects which entities caused the benefit and by how much. The Board **FURTHER AGREES** with the RPA that it is not necessary for SJG's books for 2004 to be revised at this time as it does not result in any immediate impact on rates and that SJG should retain the information and data that would allow the Company to restate the Company's financial statement for 2004 should it be found desirable or necessary to do so within a reasonable period of time. Thus, the Board **HEREBY ACCEPTS** Liberty's recommendation except with respect to the recommendation that SJG revise its books for 2004 at this time.

Liberty's recommendations ED-1 and ED-2 have been continuing issues of contention between SJG and Board Staff. While the Board finds merit in the RPA's arguments, the Board believes that by exempting smaller companies such as Marina from the separate senior officer requirement, both ratepayers and stockholders are better protected from the risks involved in a new venture. By allowing this exemption, Marina Energy, LLC will have a three (3) person board common with its parent, Marina will be treated as an RCBS, and the Company's legal rights are reserved without prejudice. Further, the Board believes that any change in directors at this point in the Company's development could add substantial market risk for both ratepayers and stockholders. It is in everyone's mutual interest to maintain the status quo at this time. Therefore, the Board **HEREBY REJECTS** the Ratepayer Advocate's arguments with respect to recommendations ED-1 and ED-2. However, the Board is concerned with allowing this exemption for smaller companies for an undetermined period of time. Accordingly, the Board **HEREBY DIRECTS** Staff to readdress this issue in the next round of Competitive Service Audits.



Additionally, the RPA has requested that the Company's request for exception regarding MO-2 be denied. The Board is persuaded by the RPA's arguments and does not believe that acceptance of this recommendation in any way precludes the Nominating and Governance Committee from seeking counsel in this regard from either the Chairman or CEO. The issue addressed in Liberty's recommendation is the autonomy of the committee. The Board does not believe there should be a requirement to take counsel from inside directors. Accordingly, the Board **HEREBY DENIES** SJG's request for clarification on this issue and **ACCEPTS** the MO-2 recommendation by Liberty.

With regard to Liberty's recommendation to adopt a lower threshold for the level of business dealings that may be permitted enterprises that board members are associated with, on one hand, and SJI entities, on the other hand (MO-7), Liberty has forwarded a letter to Staff and the Company withdrawing the recommendation. Therefore, the Board **HEREBY FINDS** that the RPA's recommendation is not suitable at this time. However, due to the heightened interest in the issue, the Board **HEREBY DIRECTS** Staff to monitor this issue on a continuing basis and include it in the next round of Competitive Service Audits.

The Ratepayer Advocate raised concerns that Liberty's recommendation GS-12 was not fully implemented and resolved in the recently approved Global Settlement involving SJG. Specifically, the RPA requests that the Board modify Liberty's Recommendation GS-12 to read verbatim the language written in the Global Settlement regarding the issue of the cost-effectiveness of the expansion. The Board is satisfied that the issue of the cost-effectiveness of the Transco Lateral was addressed and resolved in the Global Settlement. The Board also notes that Liberty's Final Audit Report was written and submitted to the Board well before the Board approved the Global Settlement. Liberty's conclusions and recommendations were based on the facts known at the time of the audit. The fact that the issue was subsequently resolved between the parties does not change Liberty's initial recommendation. Accordingly, the Board **HEREBY REJECTS** the RPA's request to rewrite Liberty's recommendation. Additionally, the RPA has recommended that the Board's Order adopting the final Report should make it clear that SJG is required to perform the recommended comprehensive analysis of capacity alternatives. The Board agrees with the RPA and **HEREBY NOTICES** that the parties have already addressed the issue of the Transco Lateral, the underlying conclusion which Liberty characterized as "the long-standing need to complete an unbiased, analytically sound analysis of the option of adding supply capacity on the east or south side of its service territory and the need for consideration of demand-side measures as an alternative to acquisitions of new capacity, still remains a concern for SJG. Therefore, SJG should continue to initiate or continue to perform the recommended comprehensive analyses of capacity alternatives. Additionally, Board Staff shall monitor this issue during the implementation process. The Board **HEREBY DIRECTS** that SJG performs comprehensive analyses of capacity alternatives.

With respect to the issue raised by the Ratepayer Advocate regarding Liberty's conclusions relating to the use of a three-factor formula to allocate certain indirect costs among affiliates, the Board notes that this is not a new issue with respect to SJG. The Company's previous Competitive Services Audit, in Docket No. GA02020101, addressed the very issue of using margin as one of the three-factors. The Board is not, at this juncture, reaching a conclusion regarding the appropriate factors to be used in the three-factor. However, the Board is nonetheless concerned about this ongoing issue and its potential impact on the utility's costs which are ultimately passed on to ratepayers. The Board also notes that other Board approved service agreements have used variations of the components included in multi-factor allocators. In all cases, margins have not been included as an allocation component in each Company's respective multi-factor allocator. Accordingly, the Board **HEREBY ORDERS** SJG to submit to the Board, for approval, a copy of its full service agreement and/or cost allocation manual,



including all allocation formulas. This filing should be submitted, with copy to the Ratepayer Advocate, within 90 days of the date of the Board Order in this matter.

With respect to customer enrollment, marketing and business development potential violations discussed in Liberty's conclusion 4A, the RPA believes that the Company's actions should be subject to a financial penalty under N.J.A.C §14:4-5.8 (a). After further review of Volume 3 of Liberty's Final Audit Report, the Board believes that several of Liberty's background findings are potential violations worthy of financial penalties. Taking into consideration these potential violations and our mission to providing fair and responsible regulation, The Board **HEREBY DEFERS** this specific issue at this time to give the Division of Energy an opportunity to discuss these potential violations with SJG, and, if warranted, recommend penalties to be assessed pursuant to N.J.A.C. §14:4-5.8 (a). In addition, the Board **HEREBY DIRECTS** SJG to file Compliance Plans with the Board that are sufficiently detailed to provide a clear direction to employees regarding their relationships with RCBSs and other vendors.

The Board is persuaded by SJG's arguments with respect to Liberty's conclusions dealing with the lease, and eventual sale, of equipment to AirLogics. SJG in its May 17, 2006 reply comments argues that this issue has been previously resolved in an August 19, 2003 Board Order accepting a Stipulation in Docket Nos. GR99070508, GR00090704, and GR0108472. In the Stipulation, to which the Ratepayer Advocate was a signing party, the Company agreed to make a payment of \$300,000 to the Remediation Adjustment Clause ("RAC") which ultimately benefited SJG's ratepayers. The Company complied with the terms of the settlement and made the payment of \$300,000 to SJG's RAC as settlement in full. The Board notes that this settlement does not preclude the Board from examining any future transactions between the utility, SJG, and one of its affiliates. Thus, the Board is not persuaded by the RPA's argument that a penalty should be assessed based on SJG's decision to enter into a below market lease, and later a below market sale, of utility assets. Therefore, the Board **HEREBY REJECTS** the RPA's recommendation to impose a sanction on SJG for its below-market lease, and later sale, of equipment to AirLogics. Liberty's recommendations ED-31 through ED-35 include a number of measures to assure that future inter-affiliate transfers of goods and services are charged at the proper costs under the Board's Affiliate Relations Standards. The Company, the Ratepayer Advocate, and Liberty agree that the Company should be required to determine the proper cost for the sale and lease transactions involving the air monitoring equipment, as well as any sale or lease transactions involving ratepayer-funded equipment. Thus, the Board **HEREBY DIRECTS** Board Staff to continue to monitor any future transactions related to utility asset transfers to ensure that SJG has determined the proper cost for the sale and lease transactions involving the air monitoring equipment, as well as any sale or lease transactions involving ratepayer-funded equipment.

The RPA has also raised a concern with the exclusion of senior officers' compliance with MO-29. The Board is persuaded by the RPA's arguments that all employees, including senior officers, should complete time sheets. Other New Jersey utilities, as well as their respective holding companies, require all employees to complete timesheets. Proper time tracking is essential to proper cost allocation. Therefore, the Board **HEREBY MODIFIES** Liberty's recommendation MO-29 to include senior officers. In addition, while not specifically recommended by Liberty, the Board finds serious merit in the Ratepayer Advocate's recommendation to require SJG/SJG to cease its use of exception timekeeping, and begin positive time reporting for SJG and affiliates. The method of positive time keeping requires all employees to track the specific time worked on activities, rather than exception time keeping whereby employees are not required to track activities unless they vary from their normal daily activities or their services are provided to a different entity. Therefore, the Board **HEREBY DIRECTS** SJG to cease its current practice of exception time reporting and instead implement positive time reporting.

Accordingly, the Board **HEREBY ACCEPTS** the withdrawal of Liberty's recommendation MO-7 and **HEREBY ACCEPTS** the remaining 135 recommendations that are delineated in Liberty's Final Audit Report, with the modifications set forth above. In addition, the Board **HEREBY ORDERS** SJG, under the supervision of Board Staff, to prepare a detailed plan for implementation of the audit recommendations, as well as any modifications ordered by this Board. Board Staff shall monitor, evaluate and modify, as necessary, the implementation of the recommendations.

Furthermore, the Board has carefully considered the RPA's comments submitted on April 25, 2006, SJG's reply comments submitted on May 17, 2006, and the Ratepayer Advocate's reply comments submitted on May 25, 2006. The RPA expressed its desire to be more involved in both the audit process, as well as the audit implementation process. The Ratepayer Advocate, in its letter, fully supported Liberty's recommendations (with a few modifications) and is concerned that the recommendations be fully and timely implemented. As all parties are aware, at the April 12, 2006 Board Meeting, President Fox directed the Division of Audits, along with the Board's Chief Financial Officer, to conduct a comprehensive review of the Board's audit process. The Board, while sharing the concerns of the Ratepayer Advocate, believes the issues raised by the RPA regarding the audit process would be better addressed in this comprehensive review of the audit process being conducted by the Board.

DATED:

9/27/06

BOARD OF PUBLIC UTILITIES  
BY:

  
JEANNE M. FOX  
PRESIDENT



FREDERICK F. BUTLER  
COMMISSIONER



CONNIE O. HUGHES  
COMMISSIONER

  
JOSEPH L. FIORDALISO  
COMMISSIONER